kotak® Institutional Equities

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Updates

Colgate-Palmolive (India): Management meeting update - Smiles with confidence

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News Roundup

Corporate

- Department of Telecom (DoT) is considering a proposal to allow MTNL to become a pan-India mobile operator. MTNL is said to have submitted a plan to the DoT for the same. (ET)
- Tata group is planning to transfer the strategic electronic division (SED) of Tata Power to another group company—Nelco. Tata power owns 49% in SED. (ET)
- Reliance Power to launch IPO from January 15-18 at a price band of Rs405-450 to raise around Rs11.7 bn (BS)
- Religare is said to be in talks to sell off a minority stake in it Religare Finvest, its wholly owned NBFC arm for Rs5 bn. Societe Generale, Goldman Sachs, Blue River Capital and few other private equity players are said to be in talks with the company. (BS)

Economic and political

- Government is considering an increase of Rs4 and Rs2 per litre in prices of petrol and diesel, respectively. The group of ministers (GoM) will consider the move in their meeting later this month (ET)
- Tamil Nadu government has warned cement companies operating in the state to lower cement prices or face a state takeover (BS)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line.

EQUITY MARKETS

	Change, %			
India	**2-Jan**	**1-day**	**1-mo**	**3-mo**
Sensex	20,465	0.8	4.4	14.7
Nifty	6,179	0.6	5.4	18.6
Global/Regional indices				
Dow Jones	13,044	(1.7)	(2.0)	(6.6)
Nasdaq Composite	2,610	(1.6)	(1.0)	(4.4)
FTSE	6,417	(0.6)	0.5	(1.8)
Nikkie	15,308	(1.7)	(2.4)	(8.8)
Hang Seng	27,075	(1.8)	(5.5)	(1.5)
KOSPI	1,839	(0.8)	(3.3)	(8.7)

Value traded - India

	Moving avg, Rs bn			
	2-Jan		**1-mo**	**3-mo**
Cash (NSE+BSE)	325.5		274.0	280.2
Derivatives (NSE)	741.9		603.1	614.5
Deri. open interest	1,147.7		855	785.6

Forex/money market

	Change, basis points			
	2-Jan	**1-day**	**1-mo**	**3-mo**
Rs/US$	39.4	0	(7)	(14)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.8	(1)	(19)	(19)

Net investment (US$mn)

	1-Jan		MTD	CYTD
FIIs	35		40	16,880
MFs	9		(340)	1,577

Top movers -3mo basis

	Change, %			
Best performers	**2-Jan**	**1-day**	**1-mo**	**3-mo**
Neyveli Lignite	251	(1.5)	3.7	136.6
Rashtriya Chem	130	5.0	61.3	118.4
MRF	7,087	(0.8)	(2.7)	90.0
NALCO	522	2.8	41.3	79.1
Reliance Energy	2,366	3.8	24.5	63.1
Worst performers				
i-Flex	1,518	0.8	(1.2)	(19.5)
Acc	1,022	(0.6)	(6.3)	(16.8)
Zee Tele	320	(0.9)	5.4	(7.8)
Container Corp	1,915	(0.8)	4.3	(10.1)
Glaxosmithkline	1,029	(0.5)	7.3	(6.5)

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Technology

Sector coverage view	Attractive

		Price, Rs	
Company	Rating	2-Jan	Target
TCS	ADD	1,049	1,175
Wipro	ADD	511	545
Infosys	BUY	1,749	2,100
Satyam Comp	BUY	437	520
HCL Tech	REDUCE	314	320
i-flex solutions	SELL	1,518	1,350
Patni	SELL	331	350
Hexaware	SELL	89	90
Polaris Softwa	SELL	125	105
Tech Mahindra	REDUCE	1,123	1,250
Mphasis BFL	REDUCE	295	290
iGate Global	NR	399	-
MindTree	ADD	538	520

Quarterly Preview—A few good buys

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- **Risk-reward still favorable in a few cases**
- **Reducing estimates on the back of change in rupee/ US$ assumption**
- **Worst-case EPS growth scenario of 7-10% assuming an economic recession in the US**
- **Moderate growth revenue growth likely for Dec '07 quarter**

We tweak our earnings estimates to reflect the rupee appreciation and changes in the macro-economic environment. Notwithstanding these changes, we find valuations attractive for select stocks. For the Dec '07 quarter, lower billing days may lead to modest revenue growth and muted operating margin performance. We maintain our Attractive coverage view on the sector. Infosys and Satyam are our top picks.

Risk-reward still favorable in a few cases

We find the risk-reward ratios of select large companies attractive despite the recent run up in stocks. We find the growth implied in the current stock prices of select stocks to be extremely conservative. We use reverse DCF to arrive at the implied revenue growth expectations assuming significant correction in operating margin and WACC of 12%.

Reducing estimates on the back of change in rupee/ US$ assumption

We align our Re/US$ estimate for FY2009 to 38.5 from 39 and for FY2010 to 37.5 from 38 earlier. This has resulted in a decline of 2% to 5% in our FY2009 and FY2010 EPS estimates. We also adjust our target prices for various stocks downwards by 2% to 5.5%. We downgrade Wipro to ADD from BUY, noting limited upside to our target price.

Worst-case EPS growth scenario of 7-10% assuming an economic recession in the US

Our worst-case EPS scenario, in the event of an economic recession in the US impacting multiple verticals, assumes 5% onsite and offshore pricing decline and Re/US$ rate of 38. We highlight that our current assumptions are based on a moderate slowdown in the US economy and on benign pricing environment.

Moderate growth revenue growth likely for Dec '07 quarter

We forecast moderate sequential revenue growth of 6-8% in US$ terms for Tier 1 companies, primarily on the back of lower billing days. Further, we expect muted operating margin performance except Satyam. We expect hiring and commentary on pricing to be the key focus areas; In our view, TCS may miss its gross add target. We expect companies to guide for 4-6% US$ revenue growth for the March 2008 quarter.

Energy

HPCL.BO, Rs374	
Rating	ADD
Sector coverage view	Neutral
Target Price (Rs)	400
52W High -Low (Rs)	380 - 223
Market Cap (Rs bn)	127

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	890.0	876.9	880.0
Net Profit (Rs bn)	13.5	9.1	9.2
EPS (Rs)	40.0	26.8	27.2
EPS gth	*503.8*	*(33.1)*	*1.7*
P/E (x)	9.3	14.0	13.7
EV/EBITDA (x)	5.5	6.9	6.0
Div yield (%)	4.8	2.7	2.7

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	51.0	-	-
FIIs	14.0	0.1	(0.1)
MFs	5.2	0.3	0.1
UTI	-	-	(0.2)
LIC	16.5	1.0	0.7

Energy

IOC.BO, Rs772	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	500
52W High -Low (Rs)	810 - 370
Market Cap (Rs bn)	910.2

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	2,149	2,198	2,195
Net Profit (Rs bn)	55.8	78.8	54.0
EPS (Rs)	46.8	66.1	45.3
EPS gth	*21.3*	*41.1*	*(31.5)*
P/E (x)	16.5	11.7	17.1
EV/EBITDA (x)	7.4	5.8	7
Div yield (%)	2.5	2.6	2.0

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	80.4	-	-
FIIs	1.9	0.1	(1.3)
MFs	1.0	0.4	(1.0)
UTI	-	-	(1.4)
LIC	2.6	0.9	(0.5)

HPCL/IOCL: If you want to play, play but buy HPCL and sell IOCL

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- **Difficult to justify valuation gap in HPCL and IOCL**
- **Earnings uncertainty prevails for all downstream R&M oil companies given government inaction**
- **Upstream companies to be also impacted by higher subsidy burden**

We recommend investors exit IOCL stock given the stock's stellar increase over the past few months and take exposure, if any, to the downstream R&M sector through HPCL stock. IOCL stock has gone up 43% over the past one month and is trading above our normalized fair value of Rs725. On the other hand, HPCL still trades at a significant discount to our normalized fair value of Rs600 despite moving up 37% in the past one month. We see similar risks to the earnings of the two companies in the current macro-environment and find it hard to justify the valuation gap between HPCL and IOCL. In fact, IOCL's EV is 2.3X the combined EV of BPCL and HPCL while the assets of BPCL and HPCL put together would be 60% of IOCL's refining assets and about 100% of IOCL's marketing assets (very roughly put). We retain our ADD rating on HPCL with a 12-month target price of Rs400 (based on 40% discount to normalized fair value on 5X normalized EBITDA) and reduce our REDUCE rating on IOCL to SELL (12-month target price is Rs500 based on 30% discount to normalized fair value on 5X normalized EBITDA). We have suspended our rating and target price of BPCL as an affiliate of Kotak Securities is providing investment banking services to it.

Difficult to justify the valuation difference based on relative assets valuation. We believe that the current relative valuations of HPCL and IOCL offer a good trading play notwithstanding the overhang of subsidy burden on the sector. Exhibit 1 gives our computations for normalized fair valuations of HPCL and IOCL. Exhibit 2 gives our estimated replacement value for R&M companies broken down by various assets. We find it hard to fathom the fact that the enterprise value (EV) of IOCL is more than twice the combined EV of BPCL and HPCL given their respective assets. BPCL and HPCL have a combined refining capacity of 37.5 mn tons as compared to 60 mn tons for IOCL (after ongoing expansions) and their marketing assets are roughly similar. At the current valuations, IOCL is trading near its replacement cost, as compared to HPCL is trading at a 40% discount. Even on P/B ratio, HPCL continues to be inexpensive at 1.09X in relation to IOCL which is trading near its all-time high of 1.9X (Exhibit 3).

High subsidy losses and lack of commensurate compensation creates earnings uncertainty for all companies. The street appears to have turned positive on the downstream oil sector on the belief that the government will resolve (partly or wholly) the subsidy issue in light of the impending initial public offering (IPO) of OIL India Ltd. We are less optimistic about this given the enormity of the problem and thus, think the optimism surrounding IOCL stock is unwarranted given that it already trades above our estimated fair valuation based on normalized marketing margins and earnings. We think HPCL offers far safer exposure to any potential resolution of the subsidy problem. It also has an additional trigger in the form of removal of octroi duty on crude oil in Maharashtra, which would improve its refining margins and earnings (Rs8.7 EPS).

We expect continued high crude prices in CY2008E without a commensurate increase in domestic retail prices to likely result in large under-recoveries for the industry and significantly impact the earnings of government-owned R&M companies in FY2008E and FY2009E. We estimate under recoveries for FY2008E at around Rs735 bn (see Exhibit 4), well above the 'budgeted' Rs550 bn of the government. Exhibit 5 shows our estimated subsidy under-recoveries for FY2008E and FY2009E in comparison with FY2006 and FY2007 actual under-recoveries. As can be seen, the net under-recoveries of the downstream R&M companies will remain high in FY2009E unless the government (1) raises retail selling prices of auto fuels, (2) increases the amount of oil bonds, and (3) increases the share of upstream companies of total under-recoveries.

High subsidy loss to impact earnings of upstream companies as well. We see high crude oil prices as increasing risks to earnings of upstream companies as well. The earnings of the downstream R&M companies are obviously under the most threat but the current crisis may force the government to increase the share of under-recoveries of the upstream companies. We note that ONGC has very modest leverage to higher crude prices under the extant subsidy-sharing formula with its share of subsidy burden practically nullifying the impact of higher crude prices, both measured in crude oil equivalent terms. Nonetheless, ONGC's consolidated earnings would benefit from higher crude prices with crude produced by OVL (5.8 mn tons in FY2007) benefiting from higher crude prices.

GAIL, on the other hand, has only moderate leverage to higher crude prices through higher LPG prices and possibly higher petrochemical prices; it is not a producer of crude oil other than very small production from a field in Cambay basin. Our subsidy estimate of Rs13.5 bn for GAIL may be at risk if the government increases the share of upstream companies compared to the 33.33% assumed by us or if crude prices sustain at current levels.

Normalized earnings forecasts are significantly higher versus actual forecasts

Comparison of normalized marketing margins with FY2009 estimates (Rs/ton)

	HPCL		IOCL	
	2009E	**Normalized**	**2009E**	**Normalized**
LPG	(10,000)	1,500	(10,000)	1,500
Naphtha	2,000	500	2,250	1,000
Gasoline	(2,750)	1,700	(2,250)	2,000
Jet fuel	2,000	1,400	2,000	1,700
Kerosene	(16,250)	600	(15,000)	600
Diesel	(1,000)	1,500	(500)	1,800
Light diesel oil	1,000	500	1,800	1,000
Low sulphur heavy stock	1,600	500	2,200	1,000
Fuel oil	1,600	500	2,200	1,000
Bitumen	1,800	1,000	2,600	1,600
EPS (Rs)	**27.2**	**70.5**	**46.8**	**64.9**
EBITDA (Rs bn)	**25.3**	**47.4**	**101.6**	**134.3**
EV (5X normalised EBITDA) (Rs bn)		237		671
Value of investments (Rs bn)		59		366
Net debt (Rs bn)		93		175
Equity value (Rs/share)		602		723
Equity value at 30% discount (Rs/share) (b)		**391**		**506**

Note:

(a) Our normalized earnings estimates are based on normalized marketing margins, actual refining margin estimates and likely impact of octroi removal for Mumbai refinerires of HPCL for FY2009.

(a) Target price for HPCL is based on 35% discount to fair value (5X normalized EBITDA plus investments).

Source: Kotak Institutional Equities estimates.

BPCL and HPCL are attractively valued versus replacement values

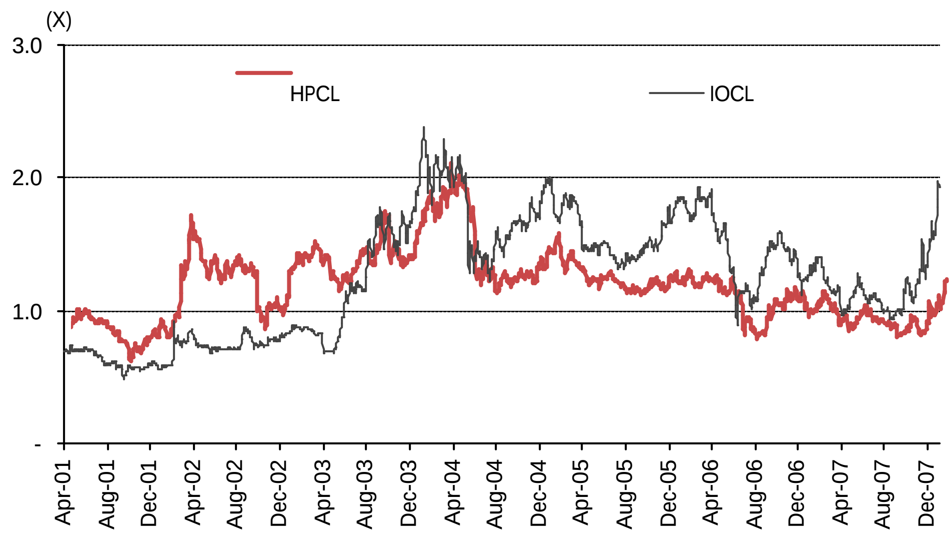
Enterprise value versus replacement cost of BPCL, HPCL and IOC (Rs mn)

		BPCL		HPCL		IOCL	
	Rs/unit	Details	Repl. cost	Details	Repl. cost	Details	Repl. cost
Replacement cost calculation							
Refining capacity (mtpa)	7,000	19.5	136,500	18.0	126,210	60.2	421,400
Product pipeline network (kms)	12.5	1,379	17,238	2,131	26,638	4,657	58,213
LOBS capacity (000 tpa)	12	180	2,160	335	4,020	270	3,240
Retail outlets (#)-land		7,537	7,021	7,909	7,370	16,607	3,364
Retail outlets (#)-fixed assets		7,537	15,074	7,909	15,818	16,607	33,214
Tanks, terminals etc. (mn kilo liters)	6,000	3.3	19,620	4.0	23,844	5.6	33,492
LPG cylinders (100% of gross block)			32,626		12,650		50,418
LPG bottling capacity (000 tpa)	10	2,082	20,820	2,154	21,540	4,028	40,280
LPG import capacity (000 tpa)	3	—	—	1,600	4,800	900	2,700
Capital WIP			8,523		15,059		43,943
Fixed assets total			259,582		257,948		690,264
Investments (@ market value)			110,118		79,929		419,172
Net working capital			14,931		12,584		84,253
Value of lubes business (@ 1X sales)			10,904		18,582		25,922
Replacement cost			**395,535**		**369,043**		**1,219,610**
Enterprise value calculation							
Outstanding shares (mn)		362		339		1,192	
Market price		516		374		772	
Market capitalization (Rs mn)			186,480		126,779		920,273
Net debt (Rs mn)			99,653		104,307		261,567
Enterprise value (Rs mn)			**286,132**		**231,086**		**1,181,840**
Current EV/RC (X)			**0.72**		**0.63**		**0.97**
Implied market price at EV/RC=60%			381		346		394
Implied market price at EV/RC=80%			600		564		599
Implied market price at EV/RC=100%			**818**		**781**		**803**

Source: Kotak Institutional Equities Estimates.

Downstream stocks are attractively valued

Price/book (price to current year-end book) ratio for BPCL, HPCL and IOCL



Source: Bloomberg, Company, Kotak Institutional Equities estimates.

Gross under-recovery in FY2008E will be significantly higher than FY2007 levels

Estimation of gross under-recovery in FY2008E, March fiscal year-ends, 2007-2008E

	2007	2008E
KIE estimated gross under-recovery in April 2007-January 2008		553
KIE estimated gross under-recovery in January 2008 (a)		91
KIE estimated gross under-recovery in balance of FY2008 (b)		182
KIE estimated gross under-recovery in FY2008E		**735**
Subsidy loss on diesel in FY2007 or in January 2008 (Rs/l)	2.0	6.8
Subsidy loss on gasoline in FY2007 or in January 2008 (Rs/l)	1.6	6.7
Subsidy loss on LPG in FY2007 or in January 2008 (Rs/cylinder)	187	343
Subsidy loss on kerosene in FY2007 or in January 2008 (Rs/l)	16.5	20.1
Crude oil (Dated Brent) price in FY2007 or in December 2007 (US$/bbl)	**64.8**	**91.5**

Note:

(a) Based on December international product prices and December retail domestic price; Dated Brent price in December 2007 was US$91.5/bbl.

(b) Gross under-recovery for balance of FY2008 computed using January 2008E gross under-recovery.

Source: MOPNG, Kotak Institutional Equities estimates.

Subsidy burden will continue to be high in FY2009E

Breakdown of subsidy under-recovery in FY2006-FY2009E (Rs bn)

	2006	2007	2008E	2009E
Dated Brent crude oil price (US$/bbl)	57	65	79	75
Subsidy loss	**400**	**494**	**735**	**579**
Payment by government (oil bonds)	**115**	**241**	**235**	**185**
Share of BPCL	22	53	53	42
Share of HPCL	23	49	49	39
Share of IOCL	70	138	133	104
Net under-recovery of oil companies	**285**	**253**	**500**	**394**
Share of refining companies	27	—	—	—
Share of upstream companies	**140**	**205**	**245**	**193**
Share of ONGC	120	170	203	160
Share of GAIL	11	15	18	14
Share of Oil India	10	20	24	19
Net under-recovery of R&M companies (BPCL, HPCL, IOCL)	**118**	**48**	**255**	**201**
Pre-tax profits of R&M companies	**74**	**96**		

Source: Kotak Institutional Equities estimates.

Energy

CAST.BO, Rs347	
Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	310
52W High -Low (Rs)	374 - 206
Market Cap (Rs bn)	42.9

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	17.5	19.5	20.2
Net Profit (Rs bn)	1.5	2.3	2.5
EPS (Rs)	12.2	18.3	20.4
EPS gth	*3.2*	*50.1*	*11.3*
P/E (x)	28.4	18.9	17.0
EV/EBITDA (x)	16.5	11.0	10
Div yield (%)	2.6	3.5	4.0

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	71.0	-	-
FIIs	2.1	0.0	(0.1)
MFs	1.8	0.0	(0.0)
UTI	-	-	(0.1)
LIC	5.7	0.1	0.0

Castrol India: Downgraded stock to REDUCE from ADD due to recent strong performance and likely higher raw material costs pressure

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- **Stock trading above 12-month target price of Rs310 after recent surge in stock price**
- **Likely increase in raw material cost due to higher crude prices provides downside risk to margins and earnings**
- **Book profits and wait for a market correction to get back in**

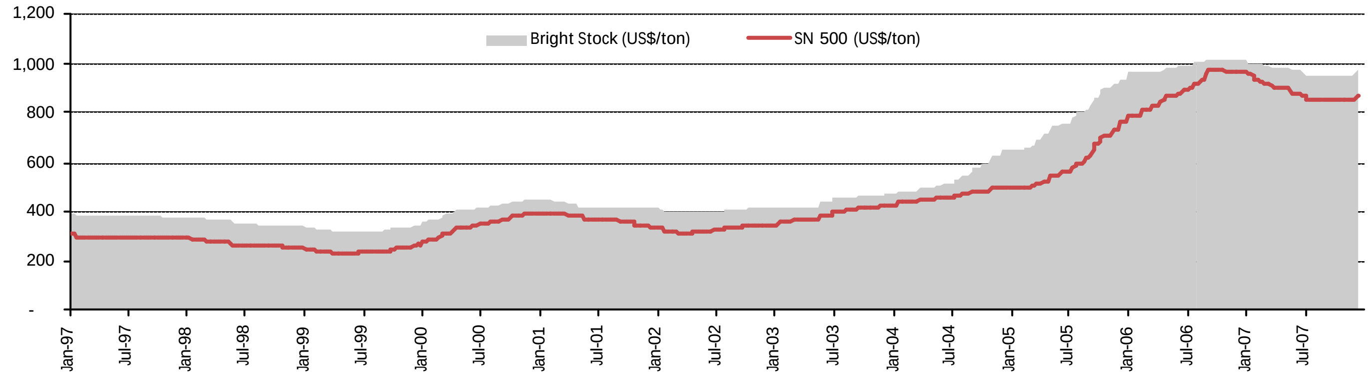
We have downgraded Castrol stock to REDUCE from ADD noting the fact that the stock is trading above our 12-month target price of Rs310 based on 15X CY2009E EPS and its strong outperformance over the past few weeks. The stock has jumped 20% over the past six trading sessions despite continued increase in raw material (LOBS) prices in turn led by high crude oil prices. We believe that the stock provides unfavorable risk-reward balance at current levels and would advise investors to book profits and wait for better opportunities at lower levels to get back in. We retain our earnings estimates. Key downside risk stems from higher-than-expected raw material costs (LOBS) due to the sharp surge in crude oil prices.

Higher LOBS prices led by surge in crude oil prices can put stress on earnings. LOBS prices have started moving up in the recent weeks (Exhibit 1) due to tightening of base oil availability as most of the producers have cut operating rates for base oils and increase fuel production instead to maximize returns. Prices have increased US$20-25/ton over the past 2-3 weeks. In India, HPCL and IOCL have raised prices by Rs1.20-1.50/kg for base oils in the recent month. The prices of LOBS had remained flat in the last three months prior to the recent increase despite a sharp surge in crude prices which have increased by US$15/bbl over the same period. This was on account of ample supply of LOBS and relatively weaker demand in China. In India, domestic base oils prices were also driven downwards due to competitive import cargo prices on appreciating rupee against the dollar.

Castrol's margins have improved significantly in the last two quarters led by (1) flat LOBS prices and (2) stronger rupee. However, we see downside risk to margins and earnings due to increase in LOBS prices. We currently model a moderate decline of US$15/ton in LOBS prices for CY2008 and CY2009. Castrol's earnings are highly leveraged to raw material costs; a US$25/ton increase in raw material costs will impact Castrol's EPS by 5-6% (Exhibit 2). Thus, any increase in raw material costs could have material impact on Castrol's earnings.

LOBS prices have started moving upwards in the recent weeks

Base oil prices (US$/ton)



Bright Stock, December calendar year-ends (US$/ton)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 YTD
1Q	382	372	328	371	444	400	414	484	660	965	996
2Q	380	359	319	405	423	398	427	501	737	980	976
3Q	380	347	322	424	415	406	456	552	812	1,005	945
4Q	376	341	334	448	413	410	470	623	913	1,013	950
Average	**380**	**355**	**326**	**412**	**424**	**403**	**442**	**540**	**780**	**991**	**967**

SN500, December calendar year-ends (US$/ton)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 YTD
1Q	297	283	239	296	386	320	358	436	502	805	930
2Q	295	271	230	335	375	316	373	452	540	867	889
3Q	293	262	237	359	362	333	405	473	613	935	853
4Q	293	256	257	383	345	345	423	491	728	967	855
Average	**294**	**268**	**241**	**343**	**367**	**329**	**390**	**463**	**596**	**894**	**882**

Weekly prices (US$/ton) (Bright Stock)

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
970	970	960	945	945

Weekly prices (US$/ton) (SN500)

Current	-1 Wk	-2 Wk	-3 Wk	-4 Wk
870	870	858	858	850

Source: ICIS, Kotak Institutional Equities.

Castrol has high leverage to raw material prices

Sensitivity of Castrol's earnings to key variables

	CY2007E			CY2008E			CY2009E		
	Downside	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**	**Downside**	**Base case**	**Upside**
Exchange rate									
Rupee dollar	41.5	40.5	39.5	40.0	39.0	38.0	39.0	38.0	37.0
Net profits (Rs mn)	2,148	2,269	2,390	2,399	2,521	2,643	2,617	2,739	2,861
EPS (Rs)	17.4	18.4	19.3	19.4	20.4	21.4	21.2	22.2	23.1
% upside/(downside)	**(5.3)**		**5.3**	**(4.8)**		**4.8**	**(4.5)**		**4.5**
Raw material price									
Raw material price (US$/ton)	835	810	785	820	795	770	805	780	755
Net profits (Rs mn)	2,117	2,269	2,421	2,371	2,521	2,670	2,590	2,739	2,887
EPS (Rs)	17.1	18.4	19.6	19.2	20.4	21.6	20.9	22.2	23.4
% upside/(downside)	**(6.7)**		**6.7**	**(5.9)**		**5.9**	**(5.4)**		**5.4**

Source: Kotak Institutional Equities estimates.

Castrol: Profit model, balance sheet, cash model, December year-ends, 2004-2009E (Rs mn)

	2004	2005	2006	2007E	2008E	2009E
Profit model (Rs mn)						
Net sales	13,051	14,304	17,524	19,525	20,154	20,805
EBITDA	**2,082**	**2,117**	**2,200**	**3,460**	**3,867**	**4,200**
Other income	221	201	344	320	320	320
Interest	(29)	(30)	(41)	(47)	(62)	(61)
Depreciation	(249)	(189)	(180)	(190)	(193)	(197)
Pretax profits	2,026	2,098	2,322	3,543	3,932	4,262
Tax	(687)	(694)	(889)	(1,310)	(1,448)	(1,563)
Deferred taxation	9	56	57	31	36	39
Net profits	**1,275**	**1,468**	**1,545**	**2,269**	**2,521**	**2,739**
Earnings per share (Rs)	**10.7**	**11.8**	**12.2**	**18.3**	**20.4**	**22.2**
Balance sheet (Rs mn)						
Total equity	3,601	3,901	4,177	4,710	5,205	5,630
Deferred taxation liability	174	119	61	31	(5)	(44)
Total borrowings	37	28	28	23	19	16
Currrent liabilities	2,830	3,238	3,619	3,494	3,482	3,487
Total liabilities and equity	**6,642**	**7,285**	**7,885**	**8,258**	**8,701**	**9,088**
Cash	297	399	892	1,294	1,675	1,987
Current assets	3,558	4,422	5,271	5,182	5,287	5,409
Total fixed assets	1,498	1,383	1,297	1,357	1,314	1,268
Investments	1,289	1,081	425	425	425	425
Total assets	**6,642**	**7,285**	**7,885**	**8,258**	**8,701**	**9,088**
Free cash flow (Rs mn)						
Operating cash flow, excl. working capital	1,576	1,544	1,403	2,108	2,357	2,576
Working capital	24	(465)	(506)	(36)	(118)	(116)
Capital expenditure	(57)	(89)	63	(250)	(150)	(150)
Free cash flow	**1,542**	**991**	**960**	**1,822**	**2,090**	**2,310**
Investments	(402)	258	687	—	—	—
Other income	37	25	9	320	320	320
Ratios (%)						
Debt/equity	0.99	0.69	0.66	0.49	0.37	0.29
Net debt/equity	0.98	0.69	0.65	0.49	0.37	0.29
RoAE	34.3	37.7	37.4	50.5	50.7	50.8
RoACE	**35.7**	**37.7**	**37.0**	**50.9**	**51.3**	**51.3**

Source: Kotak Institutional Equities estimates.

Consumer Products

COLG.BO, Rs417	
Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	455
52W High -Low (Rs)	455 - 291
Market Cap (Rs bn)	56.6

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	12.9	14.6	16.5
Net Profit (Rs bn)	2.0	2.3	2.6
EPS (Rs)	14.6	16.8	19.2
EPS gth	*33*	*14.9*	*14.1*
P/E (x)	28.5	24.8	21.7
EV/EBITDA (x)	20.7	18.8	16
Div yield (%)	2.3	3.0	3.5

Shareholding, September 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	51.0	-	-
FIIs	10.9	0.1	(0.1)
MFs	3.3	0.1	(0.0)
UTI	-	-	(0.1)
LIC	6.2	0.2	0.1

Colgate-Palmolive (India): Management meeting update - Smiles with confidence

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- **Robust volume growth to continue**
- **Benign competitive scenario, pricing power back on track**
- **HUL's market share in toothpaste lowest in ten years - HUL fighting back is a key risk**
- **Higher brand investments to continue**
- **Attractive valuation and dividend yield**

We recently met the management of Colgate Palmolive India (Colgate). The company continues to gain market shares and is confident of maintaining the growth trajectory. Toothpaste volumes are growing at about 10% (highest in three years) and Colgate with its leading market share (close to 50%) and product positioning across the category value chain is a key beneficiary. We expect the robust growth in toothpaste volumes to continue in the near term driven by higher penetration driven growth. We believe a benign competitive scenario will help Colgate chart better growth rate in the next three to five years. The key risk is re-entry of HUL in the popular segment with a product against Cibaca. At the current price of Rs406, the stock is quoting at 24X FY08E and 21X FY09E. Our target price of Rs455 implies a P/E of 27X FY08E and 23X FY09E. The stock has traded at an average P/E of 22X and 34X over the last five years and ten years (including the period in 2002/03 which marked acute price-based competition in oral category). We believe that the stock offers reasonable upside in the near-term and steady growth over the medium term. We reiterate our BUY rating and DCF based target price of Rs455/ share.

Robust volume growth to continue. Toothpaste volumes growth accelerated in 2007 to about 10% (about 6% in 2005 and 2006) driven primarily by increasing penetration. The company had achieved volume growth rates in line with the industry rates. New launches by the company in the toothpaste category during the last two years have done well—'Colgate Active Salt' and 'Colgate Max Fresh' have both achieved a market share of 5% each. Strong brand franchise in Colgate Dental cream coupled with success of value for money brand 'Cibaca' (market share gains of over 3% during 2004 – 2007) in semi-urban and rural India will help Colgate benefit significantly from the continued rural up tick. Increasing volumes and further consolidation of market shares through product innovation and re-launch will help Colgate retain its growth momentum.

Benign competitive scenario, pricing power back on track. Colgate as well as Hindustan Unilever (HUL) has taken price increases of 4-5% in the toothpaste category during June 2007. We believe that the category has significantly gained from the benign competitive scenario (Oral care being a non-focus category for Unilever, lower regional competition). The consistent price increases of ~5% in June/July every year over the last three years in key SKUs by both Colgate and HUL vindicates our thesis. The regional brands which made significant inroads into the top two players market shares in the early part of the decade seems to be now losing out as indicated by their declining or stagnant market shares. Dabur, after the acquisition of Balsara brands (Babool, Meswak), is consolidating its position as a strong no.3 in the category and has touched a highest ever market share of 9% in 2QFY2008. However, Dabur's positioning under the Ayurvedic plank would help them create and gain into a strong niche player without any significant threat to Colgate. The raw material (calcium carbonate, sorbitol) cost scenario continues to be benign and favorable to Colgate. We expect P&G to maintain a focus on making a mark in the skin-care category for the next few years.

HUL's market share in toothpaste lowest in ten years. Though oral care is a non-focus category for parent Unilever, it contributes significantly to HUL. We estimate HUL's oral care business at Rs7 bn with gross margins of about 45%. Hindustan Unilever's current toothpaste market share at 30% is the lowest in ten years. We believe that HUL will be uncomfortable to allow its market share to dip below 30% and is expected to look at various options to prevent further market share loss. The company may relaunch the existing product portfolio or may consider entering into the popular segment in toothpaste (Cibaca, Babool, Ajanta, Anchor) with a differentiated product. We believe that the USP of this segment is price. We recall that in early 2000/01, HUL had tried entering this segment with the 'AIM' brand at a 40% price discount to the existing portfolio. Lack of adequate media support and formulation unacceptability (it was a Neem based product) to the masses resulted in the company withdrawing the product. Any new competitive activity by HUL addressing this segment poses as a key risk to Colgate's plans.

Higher brand investments to continue. Colgate has one of the highest advertising & promotion (A&P) spends in the FMCG industry (A&P of 16% of sales). We believe that HUL spends about 13% of sales on A&P in oral category and has significant media buying benefits (we est. about 20%) because of the leadership position as India's no.1 spender on media. Hence, to maintain the relative share of voice/share of market (SOV/SOM), Colgate needs to structurally have a higher A&P to sales ratio.

Attractive valuation and dividend yield. The company has maintained an average payout ratio of 75% over the last five years (even after investing over Rs1 bn in the new Baddi facility). We expect the payout ratio to be maintained. At the current market price of Rs406, the stock is quoting at 4% yield for FY2009E. The company has recently paid out Rs9 as part of capital reduction program (face value of the stock reduced from Rs10 to Re1 by returning Rs9 to shareholders).

At the current price of Rs406, the stock is quoting at 24X FY08E and 21X FY09E. Our target price of Rs455 implies a P/E of 27X FY08E and 23X FY09E. The stock has traded at an average P/E of 22X over the last five years including the period in 2002/03 which marked acute price based competition in oral category. We believe that the stock offers reasonable upside in the near term and steady growth over the medium term. We reiterate our BUY rating and DCF based target price of Rs455/share.

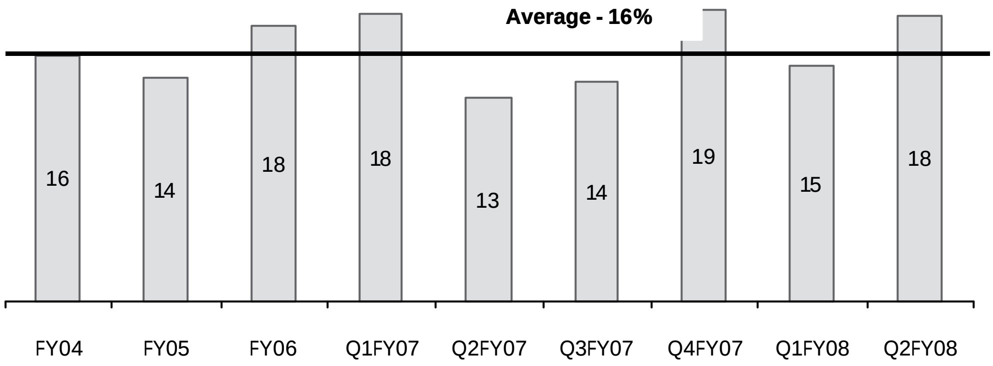
Colgate: Profit model, balance sheet, cash model 2005-2009E, March fiscal year-ends (Rs mn)

	2005	2006	2007	2008E	2009E
Profit model (Rs mn)					
Net sales	**9,604**	**11,239**	**12,892**	**14,592**	**16,499**
EBITDA	**1,738**	**2,018**	**2,089**	**2,519**	**2,976**
Other income	342	196	670	565	572
Interest	(12)	(6)	(10)	(10)	(10)
Depreciation	(162)	(149)	(153)	(162)	(196)
Extraordinary items	(81)	(125)	(389)	0	0
Pretax profits	1,826	1,934	2,208	2,912	3,342
Tax	(693)	(558)	(606)	(625)	(732)
Net profits	**1,133**	**1,376**	**1,602**	**2,287**	**2,610**
Earnings per share (Rs)	**8.9**	**11.0**	**14.6**	**16.8**	**19.2**
Balance sheet (Rs mn)					
Total equity	2,498	2,711	2,805	1,868	2,193
Total borrowings	40	44	43	44	44
Currrent liabilities	3,122	3,511	4,226	4,753	5,318
Total liabilities and equity	**5,659**	**6,265**	**7,074**	**6,665**	**7,555**
Cash	561	880	1,117	262	505
Current assets	1,932	2,135	2,447	2,744	3,238
Total fixed assets	1,472	1,691	1,920	2,069	2,222
Investments	1,694	1,559	1,590	1,590	1,590
Total assets	**5,659**	**6,265**	**7,074**	**6,665**	**7,555**
Free cash flow (Rs mn)					
Operating cash flow, excl. working capital	941	1,348	1,411	2,165	2,484
Working capital	413	427	71	115	5
Capital expenditure	(730)	(332)	(600)	(311)	(349)
Investments	(449)	124	150	0	0
Free cash flow	**175**	**1,567**	**1,033**	**1,970**	**2,140**
Key assumptions					
Revenue growth (%)	2.8%	17.0%	14.7%	13.2%	13.1%
EBITDA margin(%)	41.3%	45.7%	44.9%	45.9%	46.7%

Source: Kotak Institutional Equities estimates.

Exhibit 1: Colgate invests strongly behind brands

Advertising and promotion as a % of sales



Source: Company data, Kotak Institutional Equities.

Exhibit 2: Colgate has one of the highest A&P spends in the industry

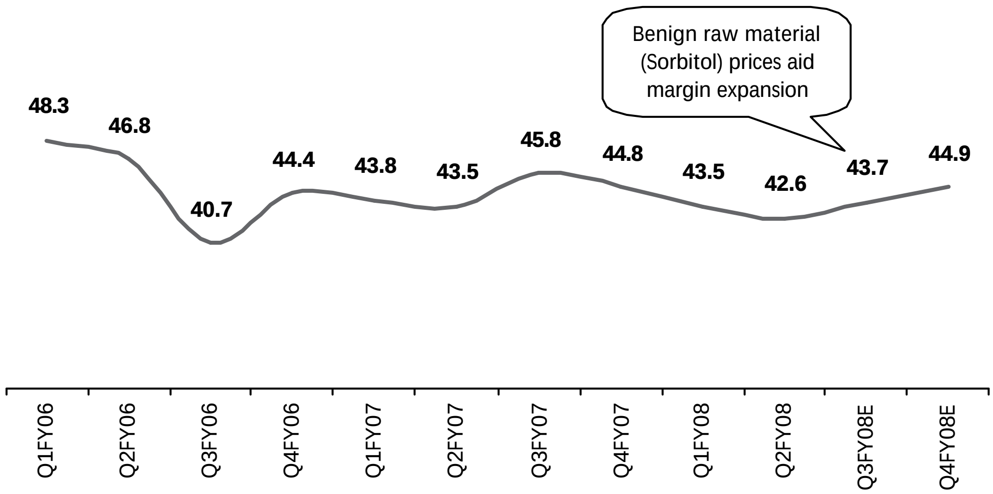
Advertising and promotion spending as a % of sales

	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07
Colgate	18.3	13.0	14.0	18.6	15.0	18.2
Hindustan Unilever	11.2	11.1	9.0	11.2	9.7	10.5
GSK Consumer	11.4	11.1	11.6	12.1	11.5	13.2
Godrej Consumer	9.4	5.3	6.1	7.5	6.5	5.9

Source: Company data, Kotak Institutional Equities estimates.

Exhibit 3: Favorable raw material price scenario

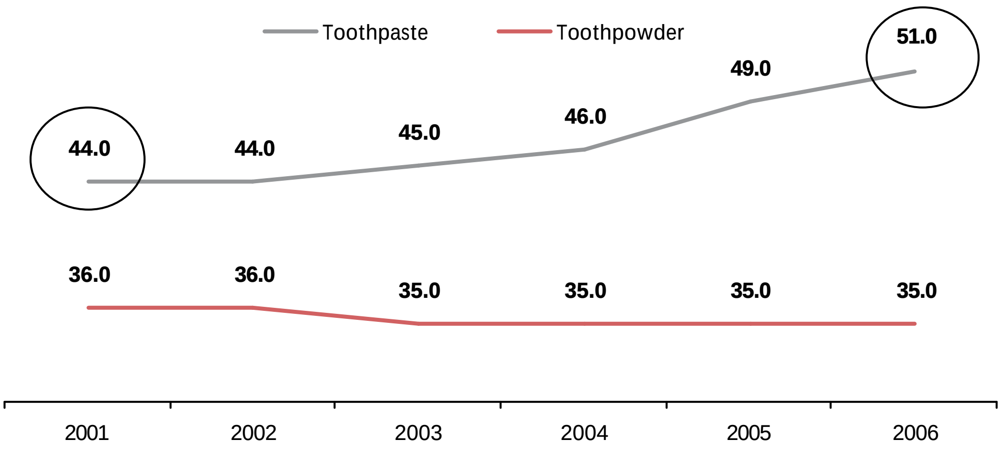
Raw material as a percent of sales



Source: Company data, Kotak Institutional Equities.

Exhibit 4: Toothpaste penetration growing at a faster clip

Toothpaste and toothpowder penetration (%)



Source: Company data, Kotak Institutional Equities.

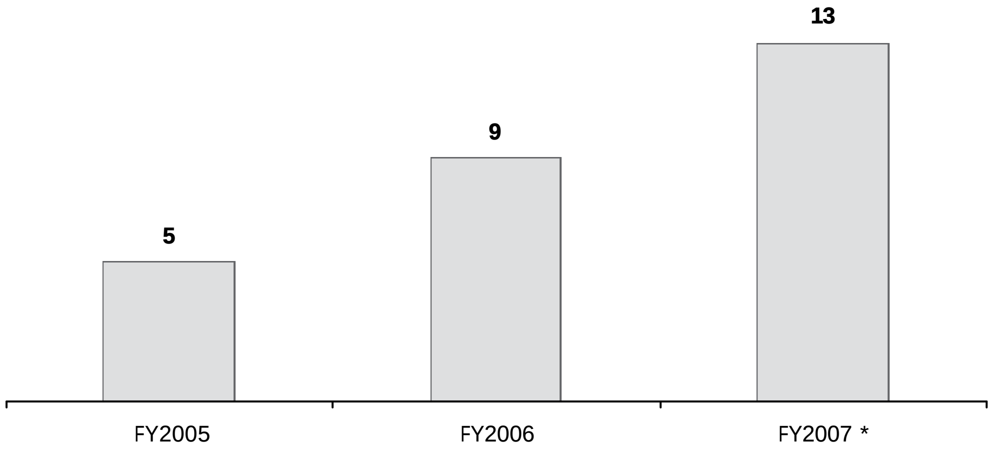
Exhibit 5: Opportunity to increase per capita consumption by increasing the frequency of brushing teeth

	Per Capita Consumption (Grams/HH/Month)	Twice a day brushing %
China	219	61
Malaysia	285	86
India - Urban	92	7

Source: Company data.

Exhibit 6: Accelerating market growth

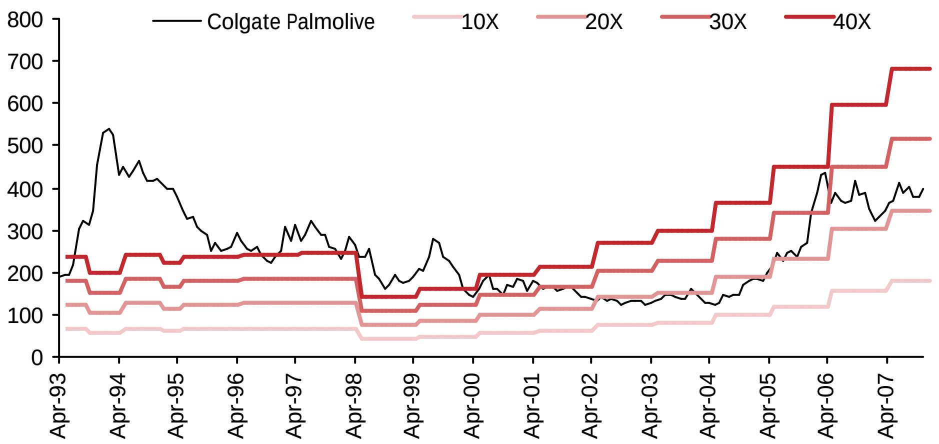
Value market growth (%) yoy



Note : FY2007 is year to date data for 2007

Source : Market sources, Kotak Institutional Equities.

Exhibit 7: Colgate-Palmolive - PE bands



Source:Kotak Institutional Equities estimates

Automobiles

Sector coverage view			Attractive

		Price, Rs	
Company	**Rating**	**2-Jan**	**Target**
Bajaj Auto	BUY	2,601	2,750
Tata Motors	BUY	794	915
Maruti Suzuki	BUY	994	1,200
Mah & Mah	BUY	860	875

Dec 07 sales: Passenger cars continue to grow even as 2-wheeler volumes slump

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- **Bajaj Auto: Motorcycle volumes dip once again as industry growth remains sluggish**
- **Hero Honda: Volumes decline 5% yoy in line with industry**
- **TVS Motors: Volumes decline 13% yoy**
- **Maruti: Volume growth led by SX4, new launches to power growth in CY2008**
- **Tata Motors: M&HCV sales grow on mom basis; LCV volumes continue to be strong**
- **M&M: UV volumes down; Logan volumes continue to decline**

Passenger car volumes continued to grow in December'07 even as 2-wheeler volumes continued to slump. Bajaj, Hero Honda and TVS have all recorded a dip in motorcycle volumes. We believe that the sluggish trend in 2-wheeler volumes is likely to continue for a while and volume growth would be under pressure despite new launches by these companies. Meanwhile, passenger car segment continues to grow with Maruti recording strong compact car and mid-size car sales. We believe that the large number of new launches expected in CY2008 will likely result in strong volume growth for the entire industry. M&HCV volumes seem to be picking up with positive volume growth on a mom basis. We believe that the CV industry is poised for an upturn resulting in positive CV growth going forward.

Bajaj Auto: Motorcycle volumes dip once again as industry growth remains sluggish

Bajaj Auto reported a 6% yoy decline and a 16% mom decline in motorcycle sales in Dec’07. Three-wheeler sales for Bajaj were down 20% yoy in Dec’07. Total exports grew 29% yoy for the month. The entire 2-wheeler industry remains sluggish as rise in interest rates along with stricter financing norms and financier’s reluctance to extend credit for 2-wheelers is hurting the industry. We believe that despite a slowing industry, Bajaj would be able to do well with its “XCD” achieving its expected targets.

Hero Honda: Volumes decline 5% yoy in line with industry

Hero Honda’s 2-wheeler volumes declined 5% yoy in Dec’07. This is in line with peers as well as industry mainly on account of 2-wheeler financers’ pulling back and becoming stricter on extending loans for motorcycles. We believe that the sluggish trend in 2-wheeler volumes is likely to continue.

TVS Motors: Volumes decline 13% yoy

TVS Motors reported a 13% yoy decline in motorcycle sales for Dec’07 while overall 2-wheeler volumes declined 5% yoy. Scooty sales declined 12% yoy. TVS launched its 125cc “Flame” in December while it plans to launch few more models within the next few months. TVS plans to launch an electric scooter and an upgraded version of ‘Apache RTR’ in the January-February 2008. We believe that despite the new launches slated by TVS, volumes would not pick as it would continue to face pressure from Bajaj and Hero Honda.

Maruti: Volume growth led by SX4, new launches to power growth in CY2008

Maruti's domestic sales grew at 7% yoy while exports grew 75% yoy in Dec'07. Overall volumes grew 10%. Domestic sales were down 10% on a mom basis mainly because of higher festival season sales in November. The entry-segment declined 1% yoy while it grew a sharp 27% on a mom basis. Compact car sales for Maruti grew at 3% yoy. However, the success of SX4 continued to result in a strong growth in mid-size car segment as volumes grew 55% on a yoy basis. Maruti plans to launch the sedan version of Swift in the first quarter on CY2008. We believe that the new launches of Swift sedan and the Splash along with strong growth in exports would drive Maruti's volume growth in FY2009.

Tata Motors: M&HCV sales grow on mom basis; LCV volumes continue to be strong

M&HCV sales declined 10% yoy in Dec'07 while it grew 9% on a mom basis. The LCV segment grew at 19% yoy led mainly by sales of the "Ace" and its passenger version. Overall domestic CV sales grew 2% yoy. CV exports grew marginally at 1% yoy. The UV segment sales declined 6% yoy while passenger car sales dropped 11% yoy in Dec'07. We believe that M&HCV sales are set to pick up as is evident from a pick up in volumes on a mom basis. In the passenger car segment, the lack of newer models to replace the Indica and the Indigo is hurting sales even as Maruti and other passenger car manufacturers record volume growth led by new launches. Tata Motors is all set to unveil its Rs100,000 small-car while it has lined up the launch of its new compact car by mid-FY2008. We believe that the launch of the new compact car, the Rs100,000 car and an upturn in the CV cycle augurs well for Tata Motors. We are positive on Tata Motors.

M&M: UV volumes down; Logan volumes continue to decline

M&M's UV sales declined 12% yoy and 22% mom in Dec'07. Meanwhile, Logan sales dropped 4% mom. We note that Logan volumes have been declining consistently on a mom basis indicating that the car is not doing as well as expected. Tractor volumes were up 3% yoy led mainly by a surge in tractor exports even as domestic volumes continue to be flat—exports grew 32% yoy while domestic volumes were flat.

4-wheelers Dec 2007 sales performance

	Dec-07	Dec-06	yoy %	Nov-07	mom %	YTD, FY2008	YTD, FY2007	yoy %
Tata Motors								
M&HCV	15,689	17,274	-9.2%	14,426	8.8%	112,871	121,813	-7.3%
LCV	12,972	10,905	19.0%	12,469	4.0%	102,659	89,393	14.8%
Domestic CV sales	28,661	28,179	1.7%	26,895	6.6%	215,530	211,206	2.0%
CV Exports	3,556	3,507	1.4%	2,813	26.4%	28,546	25,640	11.3%
Total CV	**32,217**	**31,686**	**1.7%**	**29,708**	**8.4%**	**244,076**	**236,846**	**3.1%**
UV	3,739	3,973	-5.9%	3,903	-4.2%	33,207	32,543	2.0%
Passenger Cars	11,722	13,097	-10.5%	13,336	-12.1%	129,646	137,177	-5.5%
Total	**47,678**	**48,756**	**-2.2%**	**46,947**	**1.6%**	**406,929**	**406,566**	**0.1%**
Mahindra & Mahindra								
UVs	9,909	11,274	-12.1%	12,662	-21.7%	105,760	87,978	20.2%
LCVs	802	724	10.8%	812	-1.2%	7,904	6,087	29.9%
Logan	1,504			1,561	-3.7%	17,781	-	
Tractors	6,962	6,759	3.0%	8,066	-13.7%	75,732	79,060	-4.2%
3 Wheelers	2,052	2,559	-19.8%	2,811	-27.0%	25,152	23,877	5.3%
Total	**21,229**	**21,316**	**-0.4%**	**25,912**	**-18.1%**	**232,329**	**197,002**	**17.9%**
						-	-	
Maruti Udyog								
Entry (A) segment	7,190	7,289	-1.4%	5,653	27.2%	51,985	60,128	-13.5%
Van-segment	8,034	6,523	23.2%	7,331	9.6%	65,559	58,758	11.6%
Compact (B) segment	39,575	38,461	2.9%	47,641	-16.9%	367,395	305,658	20.2%
Mid-size (C) segment	3,291	2,127	54.7%	4,260	-22.7%	36,902	22,870	61.4%
MUV	311	240	29.6%	331	-6.0%	2,792	2,316	20.6%
Domestic	**58,401**	**54,640**	**6.9%**	**65,216**	**-10.4%**	**524,633**	**449,730**	**16.7%**
Exports	4,114	2,345	75.4%	4,483	-8.2%	37,990	25,082	51.5%
Total	**62,515**	**56,985**	**9.7%**	**69,699**	**-10.3%**	**562,623**	**474,812**	**18.5%**

Source: Company, Kotak Institutional Equities.

Reported monthly sales of top two-wheeler companies - Dec 2007

	Dec-07	Dec-06	yoy %	Nov-07	mom %	YTD, FY2008	YTD, FY2007	yoy %
Bajaj Auto								
Ungeared Scooters	808	116	596.6%	1,724	-53.1%	18,308	7,331	149.7%
Motorcycles	176,441	187,063	-5.7%	209,876	-15.9%	1,659,705	1,843,655	-10.0%
Total 2-Wheelers	**177,249**	**187,179**	**-5.3%**	**211,600**	**-16.2%**	**1,678,013**	**1,856,240**	**-9.6%**
3 Wheelers	22,221	27,749	-19.9%	24,197	-8.2%	220,636	237,198	-7.0%
TVS Motor								
Motorcycles	51,293	58,756	-12.7%	57,113	-10.2%	471,306	712,095	-33.8%
Scooty	14,568	16,616	-12.3%	22,566	-35.4%	159,018	198,199	-19.8%
Moped	31,715	27,816	14.0%	33,087	-4.1%	230,148	248,345	-7.3%
Total 2-Wheelers	**97,576**	**103,188**	**-5.4%**	**112,766**	**-13.5%**	**983,308**	**1,158,639**	**-15.1%**
Hero Honda								
Total 2-Wheelers	240,532	252,462	-4.7%	288,027	-16.5%	2,453,067	2,480,772	-1.1%

Source: Company, Kotak Institutional Equities.

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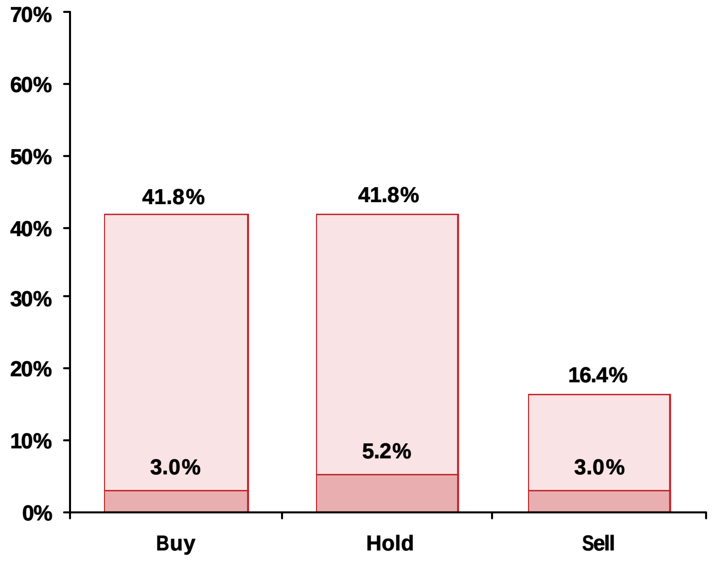
Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 09/30/07 Kotak Institutional Equities Investment Research had investment ratings on 144 equity securities.

Source: Kotak Institutional Equities. As of September 30, 2007

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.
ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.
REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.
SELL: We expect this stock to underperform the BSE Sensexby more than 10% over the next 12 months.

Old rating system

Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.
IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.
U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.
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